Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Hollingsworth, et al.	Analyst:	Angela Raygoza	Bill Number:	SB 149
Related Bills:	See Legislative History	Telephone:	845-7814	Amended Date:	March 7, 2007
		Attorney:	Dan Biedler	Sponsor:	

SUBJECT: Sales or Use Tax Paid For Freeze Relief Products Credit

SUMMARY

This bill would provide an income or franchise tax credit for the sales or use tax paid on certain products that aided in the relief from the January, 2007, freeze.

SUMMARY OF AMENDMENTS

The March 7, 2007, amendments removed language that would have allowed an exemption for sales and use tax on qualified freeze relief products and replaced it with language that would provide an income or franchise tax credit for sales and use tax paid on freeze relief products.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to provide tax relief to agricultural businesses affected by the freeze.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2007.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws provide various tax credits, designed to provide a tax incentive to taxpayers that incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they might not otherwise undertake.

Board Position:			Department Director	Date
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Current state law allows a deduction for sales and use tax paid or incurred on an item of expense, but neither federal nor state law currently provide a credit similar to the credit proposed by this bill.

THIS BILL

For taxable years beginning on or after January 1, 2007, this bill would provide an income or franchise tax credit in an amount equal to the portion of the sales or use tax paid or incurred by a qualified taxpayer on costs associated with the purchase of qualified freeze relief products from January 11, 2007, to January 19, 2007, inclusive.

This bill would define the following terms:

- “Agricultural purposes” means commercial crop production or greenhouse, nursery, and floriculture production.
- “Crop production” means the growing of crops, plants, vines, or trees, and their seeds by establishments like farms, orchards, groves, greenhouses, and nurseries that are primarily engaged in that growth.
- “Greenhouse, nursery, and floriculture production” means the growing of crops of any kind under cover or the growing of nursery stock and flowers by establishments primarily engaged in that growth.
- “Under cover” means growth of a crop that occurs in a greenhouse, cold frame, cloth house, or lath house.
- “Qualified county” means the counties of El Dorado, Fresno, Imperial, Kern, Kings, Madera, Merced, Monterey, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, Santa Clara, Stanislaus, Tulare, Ventura, and Yuba.
- “Qualified freeze relief product” means natural gas that is not piped directly to a qualified taxpayer and gasoline.
- “Qualified taxpayer” means a person using qualified freeze relief products for agricultural purposes in a qualified county that has proof of purchase and delivery of the qualified freeze products during the period of January 11, 2007, to January 19, 2007, inclusive.

This bill would specify that the Franchise Tax Board may prescribe rules and regulations necessary to administer this credit.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill provides definitions for many terms, but fails to use any of those terms in the operational language of the provision that would provide the credit. Accordingly, it is unclear what the definitions are intended to achieve.

While this bill would define the terms "qualified freeze relief products" and "qualified taxpayer," the department lacks the expertise to determine if either would meet the criteria provided in the definitions. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. It is recommended that the author amend the language to specify an entity that would be responsible for certifying that the freeze relief products purchased by a qualified taxpayer meets the requirements provided for in this bill.

TECHNICAL CONSIDERATIONS

Amendments 1 and 2 have been provided to correct technical errors.

LEGISLATIVE HISTORY

SB 114 (Florez, 2007/2008) would allow disaster loss treatment for losses sustained as a result of the January, 2007, freezing conditions in the Counties of El Dorado, Fresno, Imperial, Kern, Kings, Madera, Merced, Monterey, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, Santa Clara, Stanislaus, Tulare, Ventura, and Yuba. This bill is in its third reading in the house of origin.

SB 287 (Nava, 2007/2008) would allow a credit for wages paid to agricultural employees for employers that were affected by the January, 2007, freezing conditions. This bill is in Assembly Revenue and Taxation Committee.

AB 297 (Maze, 2007/2008) and SB 148 (Hollingsworth, 2007/2008) would add fruit and nut trees that were severely damaged by the freeze of January, 2007, to the current property tax exemptions allowed for trees subject to other specified freezes. This bill is in the Assembly Revenue and Taxation Committee.

PROGRAM BACKGROUND

Governor Schwarzenegger proclaimed 18 counties to be in a state of emergency due to the freeze of January, 2007. The eighteen counties designated as in a state of emergency are El Dorado, Fresno, Imperial, Kern, Kings, Madera, Merced, Monterey, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, Santa Clara, Stanislaus, Tulare, Ventura, and Yuba. On March 13, 2007, President George W. Bush declared 12 counties as federal disaster areas for the January 2007, California freeze. The 12 counties designated as federal disaster areas are Fresno, Imperial, Kern, Los Angeles, Monterey, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, Tulare, and Ventura Counties. This excludes El Dorado, Kings, Madera, Santa Clara, Stanislaus, and Yuba Counties.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws. These states lack a credit comparable to the credit this bill would allow.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Revenue Analysis for SB 149 – as amended 3/7/07 Operative January 1, 2007 Enactment assumed after June 30, 2007			
Fiscal Year	2007-08	2008-09	2009-2010
Revenue Impact	Loss < $150,000	Loss < $150,000	n/a

n/a: not applicable

This estimate does not consider any possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

According to the 2002 Census of Agriculture, there are 18,000 farms in the qualified counties referenced in the bill. Based on a number of factors including, but not limited to, recent damage estimates from County Agriculture Commissioners and crop insurance data from the California Department of Insurance, it is assumed 10% of the farms in targeted areas, or around 1,800 taxpayers (18,000 affected farms X 10% = 1,800) would qualify for the proposed credit during the small window of time identified in the bill. This is because farms in or near their season of harvest are likely to have taken unusual measures to combat the freeze and thereby incur the type of qualified expenses for which the proposed tax relief is aimed.

It is assumed the bill is specifically targeting income tax relief for California farmers that utilized orchard heaters and wind machines powered by "freeze-relief products" during the January 2007 freeze. Such machines typically operate using natural gas (propane) or diesel. This analysis assumes 80% of all farms that were the most affected by the January 2007 freeze can verify that they purchased qualified freeze-relief products during the specified eligibility period. This equates to a revised impact population of around 1,440 taxpayers (1,800 farms x 80% purchased qualified freeze products = 1,440 taxpayers).

Next, the amount of estimated sales or use taxes paid on qualified fuel is limited to the extent the heating machinery utilized for freeze-relief purposes was powered by gasoline (diesel) as opposed to propane. This is because, under California Code of Regulations section 1533, farmers are exempt from paying sales tax on propane used off-highway. Even though propane fuel is the cheaper, more effective, and more environmentally friendly alternative, plumbing code restrictions cause propane-heating systems to be very costly to install in California. As such, it is assumed 75% of farmers that utilized wind machines and/or orchard heaters to battle the January 2007 freeze used non-propane fuel as a power source. This analysis reduces the bill's target population further to around 1,100 taxpayers (1,440 x 75% = 1,100 taxpayers).

Based on the 2002 Agriculture Census, the average cost of fuel for California farms was $7,660 per farm. According to U.S. Department of Energy data, the average cost of fuel in January 2007, is nearly 165% of 2002 values, equivalent to an average of $12,640 per farm in today's economy. This suggests annual fuel expenses amongst the bill's target population should amount to $14 million for 2007 ($12,640 fuel x 1,100 farms). To account for the unusual demand caused by the extreme freeze, it is assumed that 15% of a qualified taxpayer's annual fuel expenses in 2007 were incurred during the specified nine-day eligibility period. This yields around $2.1 million of potentially qualified purchases ($14 million x 15% = $2.1 million). Because the proposed credit is equal to the amount of sales tax paid, the estimated revenue impact in terms of total credits generated under this proposal is approximately $130,000 ($2.1 million fuel for qualified purchases x 6% sales taxes paid).

It is assumed all credits generated are exhausted after two years.

POLICY CONCERNS

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

Current law allows a deduction for sales tax paid or incurred. This bill would allow a credit in an amount equal to the portion of the sales or use tax paid or incurred. As a result, this bill would have the economic effect of providing a dollar for dollar tax benefit in excess of 100% of the costs paid or incurred for these expenses.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 149
As Amended March 7, 2007

AMENDMENT 1

On page 4, line 21, strike "income" and insert:

taxable

On page 4, line 23, before "Section" insert:

with